LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
DEC 8 1969
JOHN F. DAVIS, CLERK

In the

Supreme Court of the United States

OCTOBER TERM, 1969

No. 926

DUDLEY E. BINYON,
Petitioner,

v.

PHILIP B. BATESON,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MERRILL L. HARTMAN,
CARLISLE BLALOCK,
3525 Southland Center,
Dallas, Texas 75201,

LEWIS P. CHANDLER, JR.,
8111 Preston Road,
Dallas, Texas 75225,
Counsel for Petitioner
Dudley E. Binyon.

THE WARLICK PRESS DIVISION, STECK-WARLICK CO.
P. O. BOX 10543 — 1455 ROUND TABLE DRIVE — DALLAS — 631-3130

INDEX

	Page
Citation to Opinion Below	1
Jurisdiction	2
Questions Presented	2
Statutory Provisions Involved	3
Statement of the Case	3
Reasons for Granting the Writ	7
Conclusion	17

Page

Cases:

Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541, 546 (1949) 10, 11, 17

deHaas v. Empire Petroleum Company, 286 F. Supp. 809 (D.C. Col. 1968) 8

Gillespie v. United States Steel Corp., 379 U.S. 148, 153 (1964) 17

Hanna v. Plumer, 380 U.S. 460, 463 (1965) 10

Henis v. Compania Agricola de Guatemala, 210 F. 2d 950 (3rd Cir. 1954), 116 F. Supp. 223 (U.S. Del. 1953) 7

Kenrich Corp. v. Miller, 377 F. 2d 312 (3rd Cir. 1967) 14-16

Land v. Dollar, 30 U.S. 731, 735 n. 2 (1947) 17

Larson v. Domestic & Foreign Commerce Corp., 337 U.S. 682, 685 n. 3 (1948) 17

Schlagenhauf v. Holder, 379 U.S. 104 (1964) 12

United States v. General Motors Corp., 323 U.S. 373, 377 (1945) 17

United States v. Robinson, 361 U.S. 220 (1959) 12

Weinhaus v. Gale, 237 F. 2d 197 (7th Cir. 1956) 7

Statutes:

Rule 23.1, Federal Rules of Civil Procedure 2, 3, 6-14, 7

28 U.S.C. 1254(1) 2

In the

Supreme Court of the United States

OCTOBER TERM, 1969

No. .....

DUDLEY E. BINYON,

Petitioner,

v.

PHILIP B. BATESON,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Petitioner, DUDLEY E. BINYON, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on August 11, 1969, as modified by *per curiam* opinion dated October 23, 1969, denying Petitions for Rehearing.

CITATION TO OPINION BELOW

The opinion of the Court of Appeals is reported at 414 F. 2d 128, and is printed in Appendix B hereto, *infra*, p. 21.

No opinion was rendered by the District Court for the Northern District of Texas.

JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit was entered on August 11, 1969, Appendix B, *infra*, p. 26. Timely Petitions for Rehearing were denied on October 23, 1969. R. 128; p. 27 *infra*. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (1).

QUESTIONS PRESENTED

1. Whether a stockholder who merely alleges that certain alleged wrongs, having their inception prior to the stockholder's purchase of stock in the corporation, are "continuing" has standing to institute a stockholders' derivative suit under Rule 23.1 of the Federal Rules of Civil Procedure.

2. Whether a stockholder who purchases stock in a corporation for the sole and exclusive purpose of bringing a stockholder's derivative suit based on alleged wrongs having their inception prior to his purchase of stock and of which he had full knowledge at the time of such purchase has standing to institute a stockholder's derivative suit by reason of his status as a former stockholder of the corporation.

3. Whether one who was a stockholder at the time of alleged intra-corporate wrongs and, having knowledge of such alleged wrongs, thereafter sells his stock has standing upon repurchase of stock in the corporation to bring a stockholder's derivative suit based upon such alleged wrongs.

STATUTORY PROVISIONS INVOLVED

Rule 23.1 of the Federal Rules of Civil Procedure, which deals with derivative actions by shareholders. Rule 23.1 is reprinted in Appendix A, p. 19 *infra*.

STATEMENT OF THE CASE

On September 21, 1967, Philip B. Bateson, Plaintiff below and the Respondent herein, filed a stockholder's derivative action seeking recovery on behalf and for the benefit of Magna Oil Corporation, whose shares are listed on the American Stock Exchange, for damages which were alleged to have resulted from certain acts of fraud, mismanagement and breach of fiduciary duty on the part of the members of the Board of Directors of Magna Oil Corporation. Respondent also named the corporation as a Defendant in his complaint. Petitioner is a member of the Board of Directors of Magna Oil Corporation.[1]

Respondent had been a shareholder of Magna Oil Corporation for a number of years prior to May of 1967. However, Respondent testified during his deposition, taken on November 8 and November 9, 1967, that he had sold all of his shares of Magna Oil Corporation (approximately 4200 or 4300 shares) by May 5, 1967 (R. 74). Respondent further testified on his deposition that he had sold his shares in Magna Oil Corporation because he knew that certain loans with the Republic National Bank of Dallas were coming up for

[1]The other members of the Board of Directors are G. B. Howell, Jake B. Goodson, Vernon C. Howell, C. L. Vickers and Richard E. Howell. These remaining directors named defendants in the suit and Magna Oil Corporation are filing a separate petition for a writ of certiorari with this Court.

attempted renewal by Magna Oil Corporation in June, 1967 (R. 67). Respondent, however, alleged that he had intended to keep 100 or 200 shares of Magna Oil Corporation stock and through alleged inadvertence this had not been done (R. 68). It was also brought out in Respondent's deposition that Respondent ordered 100 shares of Magna Oil Corporation stock from a broker on July 21, 1967, for the sole and exclusive purpose of instituting the present derivative suit (R. 68). Respondent further testified that as early as April, 1966, he had advised all Directors of Magna Oil Corporation at a stockholders' meeting that he intended to bring a stockholder's derivative action for the wrongs alleged in this suit (R. 68). Respondent received a stock certificate for the 100 shares of stock of Magna Oil Corporation on September 1, 1967, and twenty (20) days thereafter, on September 21, 1967, filed this derivative shareholder's suit. The sole basis of jurisdiction was diversity of citizenship, Magna Oil Corporation being a Delaware corporation with its principal place of business in Texas, all of the Directors being Texas residents and Respondent being a resident of the State of New York.

Motions to dismiss with supporting briefs and affidavits were filed by the various Defendants below, including Petitioner, on October 11, 1967, on October 12, 1967, and on November 6, 1967 (R. 38-42). These various motions to dismiss were set for hearing on March 1, 1968, on which date, immediately prior to the hearing, Respondent filed his reply to the Defendants' motions to dismiss (R. 60) and his supporting brief (R. 121).

At the hearing on the motions to dismiss held March 1, 1968, and after the Court had announced the granting of such motions, Respondent indicated that he desired to file an amended complaint so that he might aver that all of the alleged wrongs were "continuing wrongs". The second paragraph of the Court's Order Granting Motions of Defendants to Dismiss (R. 105, 106) states:

> "During the hearing Plaintiff in open court requested leave to amend his pleading so that he might aver that all of the alleged wrongs complained of in his complaint were continuing wrongs. The court stated that the Plaintiff could reduce said motion for leave to amend to writing and the same would be overruled."

Thereafter, on March 20, 1968, the Order Granting Motions of Defendants to Dismiss was entered by the United States District Court for the Northern District of Texas without opinion. Respondent's Motion for Leave to Amend, with a proposed amended complaint attached, was filed on March 20, 1968 (R. 79, 80). This motion, alleging in substance that the amended complaint would assert the alleged wrongs to be continuing and that Defendant G. B. Howell failed to appear and give his deposition, was overruled.

The alleged wrongdoings are set out on page 2, paragraph 2 of the Fifth Circuit's opinion (p. 22, *infra*), except that contrary to the opinion there is no allegation that any of the corporation's assets were mortgaged to secure personal indebtedness of any of the Directors, but rather the allegation is that Director G. B. Howell's bad financial condition has caused the lending institution to

place Magna Oil Corporation in bad financial condition. (R. 92-94, R. 12-14). In Respondent's proposed Amended Complaint, attached to his motion to amend, Respondent included an allegation purported to be a violation of 15 U.S.C.A. § 78p. against Director G. B. Howell, (R. 91) although not mentioned in Respondent's motion to amend. This allegation could at most affect only Director G. B. Howell and would have no effect on any of the other Director-Defendants. The Fifth Circuit mentioned this allegation in its footnote 1, but did not make it the basis of the decision for which review is sought.

The Fifth Circuit held, in reversing and remanding the District Court's decision, that the matters complained of in the present case were alleged to be wrongs that had not completely occurred and terminated prior to Respondent's purchase of his 100 shares of stock and that Respondent had met the requirement of Rule 23.1 of owning stock at the time of the wrong complained of because the wrongs were alleged to be "continuing" at the time Respondent reacquired stock in Magna Oil Corporation. In addition, the Court of Appeals held that while a "stranger" to a corporation who buys stock with knowledge of the alleged wrongs made the basis of a derivative suit may not maintain a derivative action, even if the wrongs complained of are "continuing wrongs", this rule of law was not applicable in the present case because the Respondent was not a "stranger" to the corporation since he had formerly been a long-time stockholder of Magna Oil Corporation.

REASONS FOR GRANTING THE WRIT

1. The decision of the Fifth Circuit below is in conflict with the decision of the United States Court of Appeals for the Seventh Circuit in *Weinhaus v. Galé*, 237 F. 2d 197 (7th Cir. 1956) and the decision of the United States Court of Appeals for the Third Circuit in *Henis v. Compania Agricola de Guatemala*, 210 F. 2d 950 (3rd Cir. 1954) affirming and adopting the decision of the United States District Court for the District of Delaware in *Henis v. Compania Agricola de Guatemala*, 116 F. Supp. 223 (U.S. Del. 1953). In addition, the Fifth Circuit's opinion is representative of the conflicting views and confusion existing in the Courts of Appeals and Federal District Courts in relation to the application of the concept of "continuing wrongs". This situation has created a substantial area of disorder in the area of derivative shareholder suits in the Federal Courts. Rule 23.1 of the Federal Rules of Civil Procedure requires an allegation in the complaint of a plaintiff in a derivative action that the plaintiff was a shareholder at the time of the transactions of which he complains. The Fifth Circuit, in its opinion in this proceeding, stated that where the complaint alleges "continuing wrongs", occurring at the time a plaintiff brings his derivative suit, the complaint should not be dismissed on a defendant's contention that the claims actually occurred prior to the time the plaintiff acquired his stock (p. 23 *infra.*) While there is authority in support of the theory of "continuing wrongs", the practice of alleging

"continuing wrongs" as a means of satisfying the pleading requirement as to contemporaneous ownership under Rule 23.1 has often been rejected by the Federal Courts. In both the Seventh Circuit and Third Circuit cases cited above a party by the device of employing appropriate language in his complaint, alleged that transactions which had previously occurred were "continuing transactions" in order to maintain jurisdiction under Rule 23.1 of the Federal Rules of Civil Procedure. The Courts in each case refused to permit this device to be used to satisfy the requirement of Rule 23.1. In addition, such a device has been rejected in numerous Federal District Court cases, an example being the recent case of *deHaas v. Empire Petroleum Company*, 286 F. Supp. 809 (D.C. Col. 1968) in which the Court stated at page 812:

> "* * * The transactions complained of in this case occurred between January and August of 1962. Since neither Riggins nor Wiley purchased his stock until sometime in 1964, both must be dismissed as parties to this suit. Their standing is not enhanced by the allegation in the complaint that the fraud is of a 'continuing' nature. As indicated in Pergament v. Frazer, 92 F. Supp. 9, 12 (E.D. Mich. 1949), 'every harm to a corporation is "continuing" when someone has taken away some of its assets wrongfully'. Rule 23.1(1) clearly requires that the plaintiff be a shareholder when the transactions occurred, and a mere allegation of 'continuing' fraud cannot deprive the Rule of its obvious intent. See also, Matthies v. Seymour Mfg. Co., 270 F. 2d 365, 373 (2nd Cir. 1959); Weinhaus v. Gale, 237 F. 2d 197, 200 (7th Cir. 1956); and Henis v. Compania Agricola de Guatemala, 210 F. 2d 950 (3rd Cir. 1954).
>
> Plaintiffs Riggins and Wiley will therefore be dismissed from the suit."

In addition, the only logical or plausible reason for the development of the "continuing wrongs" exception was to prevent a person who purchased stock in a corporation without knowledge of said wrongs from being precluded from rectifying such a situation on the ground that such wrongs had their inception prior to his purchase. However, permitting the use of the exception of "continuing wrongs" to allow such a suit without requiring a showing of good faith would completely defeat the whole purpose of Rule 23.1 of the Federal Rules of Civil Procedure. Since the primary purpose of this rule is the prevention of speculation in lawsuits and the purchase of lawsuits, the availability of the doctrine of "continuing wrongs" without a requisite showing of good faith would inevitably result in just such speculation and purchase of lawsuits.

As a result of the Fifth Circuit's direct conflict with the opinions of the Seventh Circuit and Third Circuit, as evidenced in this proceeding, and with the conflicts and confusion existing in numerous District Court opinions, it is obvious that the Federal Courts are in a state of disorder regarding the theory and application of "continuing wrongs" in relation to derivative suits under Rule 23.1 and there exists an urgent need for a uniform rule of law on this point due to the large number of such cases now being brought in Federal Courts. These conflicts and the lack of uniformity in such an important and frequently litigated

area justify the grant of certiorari to review the judgment below. See *Hanna v. Plumer*, 380 U.S. 460, 463 (1965).

2. The Fifth Circuit, in its opinion in this case, has created a new rule of law relating to derivative shareholder suits which is in conflict in principle with decisions of the United States Supreme Court and which is so inconsistent in theory that it leaves the intent and purpose of Rule 23.1 of the Federal Rules of Civil Procedure in a state of uncertainty. In the case of *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949), Mr. Justice Jackson, speaking for the Court at p. 556 states:

> "Rule 23 requires the stockholder's Complaint to be verified by oath and to show that the plaintiff was a stockholder at the time of the transaction of which he complains or that his shares thereafter devolved upon him by operation of law. In other words, the federal court will not permit itself to be used to litigate a purchased grievance or become a party to speculation in wrongs done to corporations."

The Fifth Circuit, in its opinion below, expressly acknowledges the fact that Respondent had knowledge of the alleged wrongs made the basis of this derivative suit at the time Respondent purchased his 100 shares of stock on July 21, 1967, and that such shares were by the Respondent's own admission purchased for the sole and exclusive purpose of bringing this derivative action. The Fifth Circuit, in its opinion, also expressly recognized the rule of law that a "stranger" to a corporation who buys stock with knowl-

edge of alleged wrongs may not maintain a derivative action based upon said wrongs even if the wrongs complained of are "continuing wrongs" (R. 128). The Court in its opinion also expressly recognized that the primary purpose of Rule 23.1 is to prevent the Federal Courts from being used to litigate purchased grievances or from becoming a party to speculative suits against corporations. In spite of such recognition by the Fifth Circuit, and the fact that Respondent, by his own admission, purchased with full knowledge of the alleged wrongs and for the sole and exclusive purpose of instituting this derivative suit based on those wrongs, the Fifth Circuit holds that Respondent is not precluded from maintaining his suit because Respondent had formerly been a long-time stockholder of the corporation and was, therefore, not a "stranger" to the corporation. In so holding, the Fifth Circuit has created a new rule of law establishing an exception to the principle laid down in *Cohen v. Beneficial Industrial Loan Corp., supra,* and which is in conflict in principle with the primary purpose of Rule 23.1. The result of this holding by the Fifth Circuit is that it will now be necessary to ascertain in derivative shareholder suits whether or not a plaintiff occupies the position of a "stranger" to the corporation. If he does not occupy the position of a "stranger" to the corporation, he will, under the reasoning of the Fifth Circuit's opinion, have standing to institute a derivative shareholder suit regardless of the limitations set forth in Rule

23.1 or any other rule of law which might otherwise preclude a plaintiff from having standing to institute such a derivative suit. The creation of such an exception is inconsistent in theory with the purpose of Rule 23.1 and leaves the intent and meaning of Rule 23.1 in a state of confusion. As stated by this Court in *Schlagenhauf v. Holder*, 379 U.S. 104 (1964), the Federal Rules of Civil Procedure should be liberally construed, but they should not be expanded by disregarding plainly expressed limitations. This is clearly what the Fifth Circuit, in its opinion in this case, has done. In addition, this Court has held that when the language of a rule of procedure is clear and unambiguous and permits of only one reasonable construction, that rule must be enforced according to its terms. *United States v. Robinson*, 361 U.S. 220 (1959).

In addition to the fact that the creation of such an exception to Rule 23.1 is in direct conflict with the above stated rules of law and practice in the Federal Courts, and the express language of Rule 23.1 of the Federal Rules of Civil Procedure, the Fifth Circuit's reasoning in creating such a rule of law is totally unsound and logically indefensible. The Fifth Circuit reasons that because the Respondent had previously been a long-time shareholder prior to his disposition of his substantial block of stock in the corporation and his reacquisition of a nominal amount of stock for the sole purpose of purchasing the right to bring this derivative action, he should not be considered a "stranger" to the corporation. Thus, according to the reasoning of the Fifth Circuit, the Respondent cannot be said to

be litigating a purchased grievance, cannot be considered a speculative litigator nor would the other rules of law which would deny standing to Respondent be applicable. This reasoning of the Fifth Circuit that prior ownership alone is capable of creating a presumption that the stockholder is not, upon reacquisition of stock in the corporation, purchasing a lawsuit or speculating in litigation, is totally without merit. Merely because the Respondent may have originally had the best interests of the corporation in mind does not mean that such would necessarily be the case at the time of reacquisition of stock for the sole purpose of instituting a derivative shareholder's suit. In fact, just the opposite should be presumed where, as in this proceeding, the Respondent sold a substantial block of stock and later reacquired only a nominal amount for the express and limited purpose of bringing this derivative action. In other words, it cannot be assumed that Respondent is not a purchaser of a lawsuit or speculator in litigation merely because he had formerly owned stock in a corporation. Due to the large number of individuals who are constantly purchasing and selling stock in public corporations, this rule of law creating an exception to Rule 23.1, based upon whether or not a plaintiff is categorized as a "stranger" to the corporation, will in all probability result in many instances in rendering the intended purpose and application of Rule 23.1 a nullity. Such a situation clearly requires the exercise of this Court's power and duty of supervision over the Federal Rules of Civil Procedure.

3. The decision of the Court of Appeals in this proceeding is directly in conflict with the decision of the United States

Court of Appeals for the Third Circuit in *Kenrich Corp. v. Miller*, 377 F. 2d 312 (3rd Cir. 1967). The Fifth Circuit, in its opinion below, stated that the Petitioner and other Defendant placed strong reliance on *Kenrich Corp. v. Miller, supra.* The Fifth Circuit stated that the Defendants cited this case in support of the proposition that because Respondent had knowledge of the alleged wrongs at the time he reacquired his stock, stock reacquired with such knowledge cannot give standing to sue regardless of whether the alleged wrongful acts were "continuing wrongs." This is not the rule of law upon which the *Kenrich* case is based, nor the rule of law for which the Petitioner and the other Defendants below cited the *Kenrich* case. The *Kenrich* case stands as a separate and distinct basis for precluding Respondent from maintaining this derivative action, a basis separate and apart from any rule of law relating to knowledge of the Respondent of the alleged wrongs at the time he reacquired stock in Magna Oil Corporation. The Court, in the *Kenrich* case, at p. 314, stated that:

> "One who was a stockholder at the time of intra-corporate wrong and, knowing of the wrong, thereafter sold his stock has in legal contemplation become a stranger to any controversy about the matter. Mitchell v. Beachy, 1921, 110 Kan. 60, 202 p. 268. Admittedly, Kline knew of the alleged wrongs when he sold his stock."

Such a sale, in effect, constitutes a waiver of all rights to maintain a derivative suit based on such intra-corporate wrongs of which the Respondent had knowledge at the time of his original sale of all of his stock of Magna Oil Corpora-

tion and constitutes a basis for denying standing in this suit separate and distinct from the rule stated by the Fifth Circuit relating to the estoppel of a purchaser of stock with knowledge of intra-corporate wrongs to maintain a derivative suit. Both rules of law should apply regardless of the alleged designation of the wrongs as "continuing wrongs." The opinion of the Fifth Circuit, in holding that the *Kenrich* case is not applicable to the case before this Court, clearly demonstrates that the Court erred in its construction of the holding in the *Kenrich* case. In addition, the Fifth Circuit, in its opinion, distinguishes the *Kenrich* case from the case before this Court solely on the basis that the stockholder in the *Kenrich* case sought to maintain suit by way of an assignment and there was a finding that the assignment was champertous which constituted additional equitable grounds for denying the plaintiff in *Kenrich* the right to maintain suit. Such a construction of the case by the Fifth Circuit is clearly erroneous. In reality, the Court in the *Kenrich* case was dealing with two separate and distinct grounds upon which the suit by the plaintiff might have been maintained, neither dependent upon the other in a determination of whether either would supply the plaintiff with standing to bring his suit. The Court in the *Kenrich* case first dealt with the right of the plaintiff to maintain suit based upon an assignment to the plaintiff by Kenrich Corporation of a direct cause of action of Kenrich Corporation against the former directors of a corporation, which had been merged into Kenrich Corporation, for intra-corporate wrongs by the directors of the merged corporation.

The plaintiff was a former stockholder of the merged corporation. Accordingly, it was held that the plaintiff could not maintain suit on the basis of the assignment because the assignment was champertous. However, since the plaintiff's complaint in the *Kenrich* case on its face indicated nothing more than a pure derivative suit seeking redress for harms suffered by a Delaware corporation at the hands of its former directors, the Court had to determine the separate and distinct question of whether the plaintiff had standing individually as a former stockholder of the merged corporation to maintain a derivative stockholder's suit against the former directors of the merged corporation without reference to the assignment mentioned above. As stated above, the Court held that "One who was a stockholder at the time of alleged intra-corporate wrong and, knowing of the wrong, thereafter sells his stock has in legal contemplation become a stranger to any controversy about the matter." As also stated above, the Court in the *Kenrich* case was dealing with two separate and distinct grounds upon which the suit by the plaintiff could have been maintained, neither dependent upon the other in a determination of whether either would supply the plaintiff with standing to bring his suit. Consequently, it is abundantly clear that the Fifth Circuit, in this case, misconstrued the holding in the *Kenrich* case and, as a result of such erroneous construction, has handed down a decision which is in direct conflict with the holding in the *Kenrich* case. The importance of this question and the existence of such conflict

clearly makes it necessary for this Court to exercise its powers of supervision over the Federal Rules of Civil Procedure.

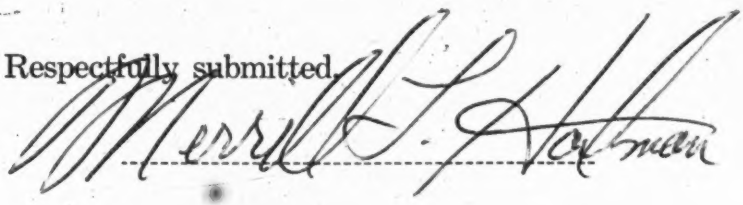
4. Although this Petitioner is asking this Court to review a non-final judgment, the issues of law in this case are fundamental to the further conduct of the case. *Land v. Dollar*, 330 U.S. 731, 735 n. 2 (1947); *Gillespie v. United States Steel Corp.*, 379 U.S. 148, 153 (1964); *United States v. General Motors Corp.*, 323 U.S. 373, 377 (1945); *Larson v. Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 685 n. 3 (1948). If review is not permitted, Petitioner will be deprived of the right to be free from purchased litigation or speculation in wrongs done to a corporation prohibited by Rule 23.1 of the Federal Rules of Civil Procedure. It appears that the right claimed by Petitioners under Rule 23.1 is "separable from, and collateral to, rights asserted in the action, too important to be denied review and to be independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated". *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 546 (1949).

CONCLUSION

On the Supreme Court rests the prime responsibility for the proper functioning of the Federal Judiciary. Because of the threat to the goal of uniformity of federal procedure posed by this decision of the Fifth Circuit and the need for a uniform rule of law on the points of procedure raised in

this petition and because of the public importance of the proper interpretation and uniform application of Rule 23.1 of the Federal Rules of Civil Procedure, a writ of certiorari should issue to review the judgment and opinion of the Fifth Circuit.

Respectfully submitted,



MERRILL L. HARTMAN,
CARLISLE BLALOCK,
3525 Southland Center,
Dallas, Texas 75201,

LEWIS P. CHANDLER, JR.,
8111 Preston Road,
Dallas, Texas 75225,
Counsel for Petitioner
Dudley E. Binyon.

December 2, 1969

APPENDIX A

Rule 23.1, Federal Rules of Civil Procedure

Rule 23.1. Derivative Actions by Shareholders.

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.

APPENDIX B

In the

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 26130

PHILIP B. BATESON,
Plaintiff-Appellant,

versus

MAGNA OIL CORPORATION, et al.,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Texas

---

(August 11, 1969)

Before THORNBERRY and SIMPSON, Circuit Judges, and CASSIBRY, District Judge.

THORNBERRY, Circuit Judge: The question presented is whether a stockholder who sold his stock and shortly thereafter re-acquired stock in the corporation for the purpose of filing a long-planned stockholders' derivative suit has standing to maintain the suit under Rule 23.1 of the Federal Rules of Civil Procedure. We hold that he does.

Appellant filed a stockholders' derivative suit on behalf of Magna Oil Corporation against the directors of the corporation. He seeks recovery for the benefit of the corporation for damages resulting to the corporation from alleged acts of fraud, mismanagement, conspiracy, and breach of fiduciary duty on the part of the defendant directors. Appellant com-

plained of six transactions, five of which are alleged to be continuing transactions begun before the filing of the action and continuing at the time of the filing of the suit.[1]

The five transactions that are alleged to be continuous in nature are: (1) That defendant Howell caused Magna to advance him money on open account and promissory note. (2) That defendant Howell caused Magna to buy an airplane which is used more for the benefit of Howell than for the Corporation. (3) That defendant Howell has caused Magna to pay him and his brother excessive salaries and expense allowances. (4) That defendant Howell has caused the Corporation's property to be mortgaged at a nearly prohibitive rate in order to secure the payment of Howell's personal indebtedness. (5) That defendant Howell has caused certain of Magna's oil and gas properties to be mismanaged.

Appellant owned several hundred shares of Magna stock continuously from 1956 to May 5, 1967. On the latter date all of his Magna stock was sold. Appellant stated in his deposition that he had intended to retain one or two hundred shares because "he had long since planned this suit." On July 21, 1967, appellant bought one hundred shares of Magna stock for the stated purpose of bringing this suit. He filed suit on September 21, 1967. The lower court dismissed the action, apparently on the basis that the "contemporaneous ownership" requirement of Rule 23.1 had not been met.[2] Appellant appeals that decision.

[1]The sixth transaction complained of involves insider short-swing profits and an alleged violation of the Securities Exchange Act of 1934. It has been held that since an action to recover insider short-swing profits may be brought "by the owner of any security," 15 U.S.C.A. § 78p, plaintiff need not allege that he was a stockholder at the time of the transaction complained of *Blau v. Mission Corp.*, 2d Cir. 1954, 212 F. 2d 77, cert. denied, 347 U.S. 1016, 74 S.Ct. 872, 98 L.Ed. 1138.

[2]Rule 23.1 requires, inter alia, that in a stockholder's derivative action, the complaint shall allege "that the plaintiff was a shareholder . . . at the time of the transaction of which he complains." This requirement serves the dual purpose of preventing a collusive attempt to invoke federal jurisdiction, *Hawes v. City of Oakland*, 1882, 104 U.S. 450, 26 L.Ed. 827, and of preventing a person from buying a lawsuit.

The Rule makes it clear that one who buys stock in the corporation cannot maintain a stockholders' derivative suit if the wrongs complained of were completed before his acquisition of stock. However, where the complaint charged continuing wrongs, occurring at the time plaintiff owned stock, the complaint should not be dismissed on defendant's contention that the claims actually arose prior to the time plaintiff acquired his stock. 1 Barron & Holtzoff, *Federal Practice and Procedure* § 566, p. 303 (Wright ed. 1961); *Hoover v. Allen*, D.C.N.Y. 1960, 180 F. Supp. 263. In other words, the requirement that a shareholder must have owned stock at the time of the wrong of which he complains may be satisfied if the wrong is a continuing one, that is, if it "spans the plaintiff's ownership, or if new elements in a pattern of wrongful conduct occur after acquisition." Prunty, *Business Associations*, 35 N.Y.U.L. Rev. 1468 (1960).

This Court has set forth certain guidelines and tests for continuing transactions. In *Palmer v. Morris*, 5th Cir. 1963, 316 F.2d 649, the plaintiff charged the defendants with wrongdoing for certain transactions entered into prior to plaintiff's acquisition of the stock. It was alleged, however, that the company was still paying out sums of money pursuant to the earlier transactions and that these sums of money, both in the form of allegedly non-beneficial services for the company and in the form of allegedly exorbitant rentals, were still being made. The Court stated:

> Each of the counts . . . sufficiently stated the facts and circumstances touching on the alleged illegality of the payments currently being made so that these counts could not be dismissed as dealing only with transactions that had completely occurred and been terminated prior to plaintiff's acquisition of his stock. We are unable upon the basis of the record itself to determine that as a matter of law these counts failed to assert illegal conduct by the officers of the company subsequent to the acquisition of the stock by the plaintiff and at a time when he had a right to complain thereabout.

Id. at 650.

The matters complained of in the present case are not wrongs that have "completely occurred and been terminated prior to plaintiff's acquisition of his stock," and therefore, under the *Palmer* test, are continuing wrongs. Thus it would seem that appellant has met the requirement of owning stock at the time of the wrong complained of because the alleged wrongs were continuing at the time he re-acquired stock in Magna.

Appellees claim, however, that this suit was properly dismissed because appellant had knowledge of the alleged wrongs at the time he re-acquired his stock, and stock acquired with such knowledge cannot give standing to sue regardless of whether the allegedly wrongful acts were "continuing wrongs." In support of this argument, appellees place strong reliance on *Kenrich Corp. v. Miller*, 3d Cir. 1967, 377 F.2d 312, in which the court stated that one who was a stockholder at the time of an alleged intracorporate wrong and *sells* his stock with knowledge of the wrong loses any rights he may have had to bring suit in behalf of the corporation. That case, however, is not in point. There, the plaintiff had been the president and principal stockholder in the company, but he had sold all of his stock two years before the suit was instituted. He sought to maintain the suit by way of an assignment from another stockholder, and there was a finding that the assignment was champertous. Clearly, there was strong reason for applying estoppel principles against that plaintiff, whose apparent purpose in maintaining the derivative suit was to gain personal profit.

Estoppel principles will also work to deny standing to a plaintiff who *buys* stock with knowledge of the wrongs of which he complains. *See, e.g., Von Schlemmer v. Keystone Life Ins. Co.*, 121 La.2d 987, 46 So. 991 (1908); *Wagner Electric Corporation v. Hydraulic Brake Co.*, 269 Mich. 560, 257 N.W. 884 (1934). While a *stranger* to the corporation who buys stock with knowledge of the alleged wrongs may not maintain a derivative action even if the wrongs complained of are continuing wrongs, that rule is not applicable here. Appellant is no stranger to the corporation. He

was a long-time stockholder of Magna who apparently was concerned with the management of the company, and had planned to bring a derivative suit as early as April, 1966. Although it is true that he sold his stock (allegedly through inadvertence), he bought back a hundred shares in the corporation shortly thereafter. He bears no resemblance to the outsider who finds out about intracorporate misconduct and buys stock to foment litigation. Appellees' argument that appellant does not have standing to maintain this action loses sight of the purpose of Rule 23.1. That purpose is to prevent the federal court from being used to litigate purchased grievances or from becoming a party to speculative suits against corporations. *Cohen v. Beneficial Industrial Loan Corp.*, 1949, 337 U.S. 541, 556, 69 S. Ct. 1221, 1230, 93 L.Ed. 1541. Certainly, it cannot be said that appellant is litigating a purchased grievance. He is not a speculative litigator Therefore, it would exalt form over substance to hold that appellant did not have standing to maintain this stockholders' derivative action. Appellant should have his day in court.

The order of the trial court dismissing the Complaint was erroneous and the order is VACATED and set aside. The case is REMANDED to the trial court for proceedings not inconsistent with this opinion.

In the

United States Court of Appeals

FOR THE FIFTH CIRCUIT

OCTOBER TERM, 1968

No. 26130

D. C. Docket No. 3-2241-Civil Action

PHILIP B. BATESON,
Plaintiff-Appellant,

versus

MAGNA OIL CORPORATION, ET AL,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Texas.

Before THORNBERRY and SIMPSON, Circuit Judges, and CASSIBRY, District Judge.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, vacated; and that this cause be, and it is hereby remanded to the said District Court for proceedings not inconsistent with the opinion of this Court;

It is further ordered that defendants-appellees pay to plaintiff-appellant the costs on appeal to be taxed by the Clerk of this Court.

August 11, 1969

Issued a Mandate:

In the

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 26130

PHILIP B. BATESON,

Appellant,

versus

MAGNA OIL CORPORATION, ET AL,

Appellees.

Appeal from the United States District Court for the Northern District of Texas

---

ON PETITIONS FOR THE REHEARING

(October 23, 1969)

Before THORNBERRY and SIMPSON, Circuit Judges, and CASSIBRY, District Judge

PER CURIAM: It is ORDERED that the petitions for rehearing filed the above entitled and numbered cause be and the same are hereby denied, except that the first sentence of the first paragraph on page 5 of the slip opinion dated August 11, 1969, is modified to read as follows: "With the possible exception of transaction (1), the matters complained of in the present case are not wrongs that have 'completely occurred and been terminated prior to plaintiff's acquisition of his stock,' and therefore, under the *Palmer* test, are continuing wrongs."